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Supreme Court of the United States

OCTOBER TERM 1934

No. 173

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Sarnoff-Irving Hat Stores, Inc., Bankrupt,

Petitioner,

vs.

INGERSOLL BOWDITCH, STEPHEN W. SLEEPER and FRANCIS H. APPLETON, JR., Trustees of the Real Estate Associates,

Respondents.

CONSENT OF RESPONDENTS TO PETITION FOR WRIT OF CERTIORARI AND JOINDER IN MOTION TO ADVANCE.

The respondents in the above entitled cause hereby consent to the petition for writ of certiorari heretofore filed by said petitioner, seeking to review the decision of the Circuit Court of Appeals for the Second Circuit and respectfully ask that said petition be granted.

The respondents also hereby join in the motion heretofore filed by the petitioner, praying that, if said petition shall be granted, said case be advanced and assigned for

argument with the case of *Irving Trust Company, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc.* vs. *A. W. Perry, Inc.*, No. 22, October Term 1934, or immediately thereafter.

Opinions Below.

The order of the Referee appears at p. 27 of the Record. His certificate on petition for review (R. 35 et seq.) embodies a very brief opinion, which is not reported.

The memorandum and order in the District Court are found at pp. 38 and 39 of the record. Neither is reported and there was no opinion by the Court.

Nor was there any opinion in the Circuit Court of Appeals. The order of said Court merely affirmed the decision of the District Court and appears at p. 49 of the record.

Jurisdiction.

The decree of the Circuit Court of Appeals for the Second Circuit, which the petitioner herein seeks to have reviewed, was entered June 27, 1934 (R. pp. 49-50).

The petition for writ of certiorari herein was filed on July 12, 1934; and the jurisdiction of this Court was invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (U. S. C. A. Title 28, Sec. 347 (a)).

Statement of Facts and Issue Presented.

The statement of facts is accurately set out in the petition heretofore filed. The issue is the right of the landlord to prove against the bankrupt estate of the

lessee a claim based upon the following provision in the lease, namely:

> "and for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee, or either or any of them, shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover of the Lessee and each of them damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof, less the fair rental value of the demised premises for the residue of said term." (R, 14.)

The Statute Involved.

The case turns upon the interpretation of the following sections of the Bankruptcy Act, defining provable claims.

"Section 63. Debts Which May Be Proved.

(a) Debts of the bankrupt may be proved and allowed against his estate which are

(1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; * * *

(4) founded upon an open account, or upon a contract express or implied; * * *

(b) Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against the estate."

"Section 1. (11) 'Debt' shall include any debt, demand, or claim provable in bankruptcy."

"Sec. 17. A discharge in bankruptcy shall release a bankrupt from all of his provable debts * * * "

(Bankruptcy Act of July 1, 1898 (30 Stat. 562), as amended, Sections 1, 17, 63; U. S. C. A. Title 11, Section 1, 35, 103.)

Reasons for Respondents' Consent and Joinder in Motion to Advance

The respondents agree that the clause in the lease in this case, upon which respondents' claim is based, is substantially identical with the clause which was involved in said case of *Irving Trust Company, Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc.* vs. *A. W. Perry, Inc.*, above referred to, (decision of Circuit Court of Appeals for the Second Circuit reported as *A. W. Perry Inc.* v. *Irving Trust Company, Trustee, etc.*, 69 Fed. (2d) 90) and that the decision of the Circuit Court of Appeals for the Second Circuit is the same in the two cases. The issues in the two cases are, therefore, the same.

The respondents respectfully ask that the petition be granted and the motion to advance be allowed, because they are very desirous of being heard orally upon these issues before this Honorable Court before decision shall

be rendered in said *Outfitters Operating Realty Company* case, and of presenting certain arguments bearing thereon, based largely upon previous decisions of this Court which would appear to be controlling in this case in their favor.

They desire to be heard orally in this Court, not only because the issues and principles involved, and particularly the decision which shall be rendered thereon, are of great importance to the business community in Massachusetts, where the respondents live, where their properties are situated and where they carry on their business, but also because this series of provisions in leases, having to do with termination in case of bankruptcy of the lessee and with the rights and remedies of the landlord in such cases, was an historical development which, to the best of their knowledge and belief, originated in Boston.

Many of the leading decisions, also, in the long line of cases which have adjudicated the provability or non-provability of the various kinds of claims which landlords have sought to prove, have been decisions of the Circuit Court of Appeals for the First Circuit or of the District Courts within that Circuit, for example:

In re Ells, 98 Fed. 967 (D.C. D. Mass. 1900);

Slocum vs. *Soliday,* 183 Fed. 410 (C.C.A. 1st 1910);

McDonnell vs. *Woods,* 298 Fed. 434 (C.C.A. 1st 1924);

Ex Parte Houghton, et al., Fed. Cas. No. 6725 (D.C. D. Mass. 1871);

Ex Parte Lake, et al., Fed. Cas. No. 7991 (D.C. D. Mass. 1877).

See also

Savory vs. *Stocking,* 4 Cush. (Mass.) 607 (1849).

Furthermore, three of the leading decisions by this Court, dealing with the status of the landlord's claims in bankruptcy or receivership, were brought to this Court by writ of certiorari to the Circuit Court of Appeals for the First Circuit, namely:

Wm. Filene's Sons Company vs. *Weed,* 245 U. S. 597 (1918);

Gardiner vs. *Butler & Co.* 245 U. S. 603 (1918);

Kothe, Trustee, vs. *R. C. Taylor Trust,* 280 U. S. 224 (1930).

In the case of *Manhattan Properties Inc.* vs. *Irving Trust Company,* 54 S. Ct. 385, decided by this Court February 5, 1934, the landlord sought to prove "for loss of rents payable in the future," basing the claim first upon the covenant to pay rent and, second, upon covenants that in case of bankruptcy the landlord might re-enter, and in that case the tenant would indemnify him against loss of rents for the remainder of the term. The covenant to pay rent, it may perhaps be assumed, was in the usual form. The specific indemnity agreement in one of the leases there under consideration was that, if bankruptcy proceedings should be instituted by or against the tenant, the landlord might re-enter and re-let the premises, as agent for the tenant, and that the tenant would pay, each month, the deficit, if any, accruing from the difference between the amount to be paid as rent under the lease and the amount received by the landlord upon

the re-letting. In the other lease, the agreement was that, upon bankruptcy, the lessor might re-enter and thereby terminate the lease and the lessee would "indemnify the Lessor against all loss of rent * * * during the residue of the term * * * ."

This Court, on the strength of a long line of authorities, denied the proof based on the covenant of the lessee to pay the future rent; and it denied the proof based on the indemnity covenants, not only because the obligation imposed by those covenants was to be performed at some date or dates *after* bankruptcy and was "contingent on what may happen from month to month or up to the end of the original term," but on the further ground that they constituted new contracts which came into being "not by virtue of the bankruptcy proceeding, but by force of the act of re-entry, which must occur at a date subsequent to the filing of the petition."

It would seem clear that, as these leases had not been terminated at the time of petition filed, there was no claim then in existence, on behalf of the landlord, under either lease, and that there could be no claim therefore, provable in bankruptcy, except upon the theory that the bankruptcy constituted an anticipatory breach and thereby effected a termination of the lease under the doctrine of *Central Trust Company* vs. *Chicago Auditorium Association,* 240 U. S. 581, 589. The application of that doctrine in the *Manhattan Properties* case, however, would have been inappropriate and illogical. The provisions of those particular leases indicate clearly the intent of the parties that, in the event of bankruptcy the leases should not terminate, *unless* the landlord should take the affirmative step, after petition filed, of exercising

his option to re-enter and re-possess. If he did not, the lease would continue in being and the lessee's obligation to pay rent would still exist and the successive instalments of rent would constitute valid recurring obligations of the bankrupt lessee after his discharge. Where the landlord had expressly reserved the right to decide *after* petition filed whether or not he would terminate, and had undertaken to protect himself as regards the future by indemnity covenants *in case* he elected to terminate, it would have been illogical to ignore this option provision and to apply the doctrine of anticipatory breach merely because a bankruptcy petition was filed, and thereby give the landlord the right of proof for damages against the bankrupt estate of the lessee.

If the lease was not terminated, the doctrine stated by Lord Coke (Co. Litt. sec. 513) was properly applicable, namely, that inasmuch as the rent issued out of the land, the liability therefor would not accrue, except as the right of occupancy continued and the time for payment of the successive instalments of rent arrived. The long line of decisions which have denied the right of the landlord to prove for future rent, under leases of the type just described, in many of which cases the Court has cited or relied upon Lord Coke and his statement of this doctrine, are therefore entirely sound.

The present case is essentially different. The lease here is of that kind which was distinguished by this Court near the end of its opinion in the *Manhattan Properties* case where, after stating that "there can be no debt provable in bankruptcy arising out of a contract which becomes effective only at the claimant's option and after the inception of the proceedings, the fulfillment of which

is contingent on what may happen from month to month or up to the end of the original term," this Court continued:

> "Such a covenant is not, as petitioners contend, the equivalent of an agreement that bankruptcy shall be a breach of the lease and the consequent damages to the lessor be measured by the difference between the present value of the remainder of the term and the total rent to fall due in the future."

The lease in the instant case contained the kind of agreement thus described by this Court. By its express language the lease terminated upon the filing of the petition; the landlord had no option or election; the tenant had no further right of occupancy; and no further instalments of rent could issue out of the land; but the landlord *has lost his lease and his contract.*

This provision is very far from being an attempted "evasion of the long established rule * * * by mere recourse to express covenants," as is suggested in the petition for the writ of certiorari in said *Outfitters Operating Realty Company* case (at p. 7). It is far from being "merely an agreement between the parties, contrary to the provisions of the Bankruptcy Act, giving the landlord a provable claim" as was said, for example, in the brief of *amici curiae* in support of the petition in said *Outfitters Operating Realty Company* case which was filed by counsel for the trustees in bankruptcy of Louis K. Liggett Company (at p. 10).

This difference is not a mere matter of words, to make that provable which would not otherwise be provable; it is not a mere matter of inserting an "express covenant"; it is an essential difference in the structure of

the lease. A condition is inserted in the lease, the happening of which constitutes a breach of the lease and terminates the leasehold. There is no semblance of evasion and, so far as the landlord is concerned, there is no opportunity for evasion. The provision is agreed on when the lease is made. The lessor has thereafter no control over this contingency of the bankruptcy of the lessee. If bankruptcy comes, the lease is at an end, which may or may not be an advantage to the lessor. In the natural course, termination by the bankruptcy of the lessee would be of advantage to the lessor only if rents have risen. If they have declined, the termination is an injury to the lessor for his contract of lease has been breached and lost. It is this damage for which he seeks to prove, and there can be no question of the equity of his claim. The only possibility of evasion in connection with such a clause is the possibility of evasion by the lessee who may, if he chooses, file a voluntary petition and thereby effect a termination. If it were to be held that the landlord's claim in such case, for the reasonable measure of damage which is here prescribed, could not be proved, there would be strong inducement to lessees, where rents have declined, to terminate their leases by the device of a fictitious bankruptcy and a tempting avenue to fraud would be opened.

If a measure of damages is attempted to be set up in such a lease, which is unreasonable or which involves a penalty, the remedy is not far to seek. Such unreasonable claim or penalty will be disallowed by the Court, notwithstanding the termination of the lease by the event of bankruptcy, as was done in *Kothe* vs. *R. C. Taylor Trust,* 280 U. S. 224. No landlord can by any form of

words entitle himself upon termination to a penalty or to more than a fair and reasonable measure of his damage.

The *Manhattan Properties* case, notwithstanding what may perhaps be regarded as an intimation in the portion quoted above from the latter part of its opinion, has not squarely decided the precise issue of the provability of the landlord's claim for damage under this *ipso facto* clause. It would appear that all the essential elements of the question, as applied to this type of lease, have been adjudicated in accordance with the contentions of these respondents in other decisions of this Court, to say nothing of various decisions along the same lines in the various Circuits. But the matter will not be clear and definite until this Court has spoken.

The issue is not affected or its importance diminished by the Amendments to the Bankruptcy Act approved June 7, 1934 and June 18, 1934.

It is submitted that the importance of the subject matter is not at all diminished by the recent amendment to the Bankruptcy Act, approved June 7, 1934, (Public—No. 296—73d Congress), which amended Section 63a so as to provide that certain additional kinds of claims shall be provable, among them the following (clause 7):

> "(7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the

surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided further, That the provisions of this clause (7) shall apply to estates pending at the time of the enactment of this amendatory Act."

Those provisions do not affect the present case, because by a later amendment (Public—No. 387—73d Congress), approved June 18, 1934, the following was added at the end of said clause:

"in which the time for filing such claims has not expired."

Moreover, it may well be doubted in any case whether the provisions of the Act of June 7, 1934, would be applicable to the kind of claim sought to be proved in this case. The new clause 7, thus added to Section 63a of the Bankruptcy Act, would appear to have been designed primarily, if not wholly, so far as landlords are concerned, to give them the right of proof for "future rents" or for damages under indemnity covenants relating to future rents. After providing that such claims shall be provable, it then provides that the amount allowable upon such claims shall not exceed the rent reserved in the lease for the succeeding year, and further provides that in case of "assignment of future rent claims" the court shall scrutinize the circumstances and the amount paid "in determining the amount of damages allowed assignee hereunder."

In enacting this provision the Congress obviously had in mind the decision of this Court in the *Manhattan*

Properties case, hereinbefore discussed, and the kind of claims which this Court in that case had held not provable. This is indicated both by the description in the new clause 7 of the claims which are made provable and by the limitation of the amount of proof permitted and the qualification which is inserted regarding assignment of claims. It is further confirmed by the fact that the new clause 7 is enacted definitely as an amendment of Section 63a of the Bankruptcy Act and is made applicable "whether the bankrupt be an individual or a corporation"; thus indicating that Congress had clearly in mind the fact that this Court, in the *Manhattan Properties* case, had found the provision for proof of claims for future rent, as contained in the Act of 1933, (approved March 3, 1933, 47 Stat. 1467—11 U. S. C. A. Sec. 202 (a)) inapplicable because that Act applied only to individuals and because it did not expressly amend said Section 63a.

It is, of course, the contention of these respondents that their claim in this case is provable under Section 63a (1) and (4). If the new Act of 1934 were applicable to the bankrupt estate in the hands of the petitioner, it would also be their claim that the limitations upon proof, which are imposed by the new clause 7, are applicable only to the kind of claims which are made provable by that clause, and not to claims provable under other clauses of said Section 63a; that the claim which they seek here to prove is not a claim for "future rent" and is not a claim for damages or indemnity against loss of rent. It is broader than that; it is a claim based upon a breach of the entire lease contract, because that contract was terminated by the filing of the petition in bankruptcy, and because damages for this entire breach

thereupon accrued. Whatever else this lease may be, it is a contract between the parties. Where such lease contract is breached and terminated by bankruptcy, there is no rational reason for denying to the landlord, merely because he is a landlord, the right to prove his claim for damages in an amount which fairly represents the damage sustained by him from the loss of the contract.

CONCLUSION.

For the reasons hereinbefore set out, these respondents consent to the petition for writ of certiorari and respectfully ask that said writ be issued.

For the same reasons these respondents also hereby join in the petitioner's motion that, if said writ shall issue, said case be advanced and assigned for argument with said case of *Irving Trust Company, Trustee,* vs. *A. W. Perry Inc.,* No. 22, October Term 1934, or immediately thereafter.

Respectfully submitted,

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Trustees of the Real Estate Associates.

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August 3, 1934.